Hydro Québec

# Quarterly Report

## Second Quarter 2006

### *Message from the Chairman of the Board and the President and Chief Executive Officer*

**Summary of results**

For the first half of the year, income from continuing operations totaled $1,698 million, or $272 million more than for the first half of 2005, primarily because of the recognition, during the second quarter, of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars. In keeping with the adopted hedge accounting treatment, this amount, which represents the realization of a portion of the deferred foreign exchange gain recorded on the balance sheet, has been incorporated into other operating revenue.

Income from the disposal of international interests and from their operations until the date of sale was $873 million, an increase of $843 million from 2005, chiefly because of the sale of our interest in Transelec, which gave rise to a gain on disposal of some $806 million. This transaction was part of the plan initiated in 2005 to sell off some of our foreign interests; this plan should be carried out by year end.

Net income for the second quarter was $1,442 million, compared to $402 million for the second quarter of 2005. This $1,040-million growth was generated mainly by the unusual gain on the sale of Transelec.

Net income for the first half of the year was $2,571 million, or $1,115 million more than for the same period of 2005.

**Consolidated results**

**Revenue** in the first half of 2006 totaled $5,808 million, or $233 million more than in the first half of 2005. Total electricity sales amounted to $5,370 million, a $56-million decrease from 2005. However, revenue from electricity sales in Québec was up by $67 million.

On markets outside Québec, electricity purchases and sales were down by $61 million and $123 million respectively. This reduction in net exports reflects prudent management of our energy reserves.

Other revenue rose by $289 million, primarily because of the recognition, during the second quarter, of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars.

**Total expenditure** was relatively stable at $3,017 million, up 0.6% over last year. The increase in pension expense stemming from the actuarial effect of lower long-term interest rates on financial markets and the rise in depreciation and amortization expense following the commissioning of new plant were partially offset by the reduction in short-term electricity purchases outside Québec.

**Financial expenses** were $1,093 million, or $56 million less than in 2005, mainly because of the increase in capitalized borrowing costs due to the higher volume of work done in connection with our investment program.

**Discontinued operations** contributed $873 million to net income, compared to $30 million last year, driven primarily by a gain of some $806 million on the sale in June of our interest in Transelec and a $29-million gain on the sale in February of our interest in the Cross Sound Cable underwater link.

## Segmented results

### *Generation*

In the first half of 2006, Hydro-Québec Production earned net income of $1,341 million, a year-over-year increase of $234 million, primarily attributable to the recognition, during the second quarter, of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars.

Short-term electricity sales outside Québec and, to a lesser degree, short-term electricity purchases outside Québec were both down, reflective of prudent management of our energy reserves. However, the overall impact on net income was offset by a reduction in financial expenses compared to 2005.

### *Transmission*

Hydro-Québec TransÉnergie's net income amounted to $427 million, up $228 million over last year. Revenue rose from $1,246 million in 2005 to $1,503 million in 2006, for an increase of $257 million, of which $255 million was attributable to a decision handed down by the Régie de l'énergie in April 2006. This decision gives the Transmission Provider, effective January 1, 2005, a $170-million annual increase in transmission revenue for the native load in recognition of the cost of the transmission infrastructure required to meet demand growth in Québec. This $255-million increase, $170 million of which relates to 2005 and $85 million to the first half of 2006, was recognized in the second quarter of 2006. However, the increase in revenue was curbed by a $32-million rise in depreciation and amortization expense. Financial expenses totaled $347 million, down $17 million from 2005.

### *Distribution*

Hydro-Québec Distribution posted a net loss of $48 million, versus net income of $187 million in 2005. This $235-million variance stems chiefly from the $255-million increase in the cost of native load transmission service applicable as of January 1, 2005, following a decision handed down by the Régie de l'énergie in April 2006.

Revenue from electricity sales in Québec was $4,810 million, up $67 million or 1.4% over 2005, essentially owing to the April 2005 and 2006 rate adjustments.

Sales volume was down 0.5 TWh to stand at 87.1 TWh as at June 30, 2006, mainly as a result of milder temperatures at the beginning of the year.

Expenditure was up $315 million, largely because of the increase in the cost of transmission service for the native load, in depreciation and amortization expense, and in pension expense. Financial expenses were $196 million, down $9 million from 2005.

### *Construction*

The Construction segment comprises the operations of Hydro-Québec Équipement and Société d'énergie de la Baie James.

The volume of activity totaled $838 million, as against $813 million in 2005, for an increase of $25 million. As in 2005, the current level of activity reflects the fact that several major projects requiring sizable capital outlay are being carried out for Hydro-Québec Production and Hydro-Québec TransÉnergie.

## Investment

The investment program for 2006 amounts to $4 billion. Development accounts for almost 60% of this amount, or $2.3 billion, divided up as follows: $1.4 billion for hydro projects—Eastmain-1, Chute-Allard/Rapides-des-Cœurs, Péribonka, and Eastmain-1-A/Sarcelle/Rupert—and $900 million to bring the new generating stations onto the grid, meet growth in demand from Québec customers and continue the deployment of the Energy Efficiency Plan. A further $1.7 billion will be earmarked for current operations, such as maintaining and upgrading our assets.

As at June 30, 2006, investments in fixed and intangible assets totaled $1,431 million, compared to $1,373 million in 2005. As anticipated, a large portion of this amount was devoted to hydro development projects. In the area of transmission, work continued to connect Eastmain-1 generating station, install de-icing equipment at Lévis and build Waskaganish substation as well as the lines connecting Nemiscau and Waskaganish. In distribution, efforts were maintained to meet growth in baseload demand, improve service quality, notably with the Customer Information System (CIS) project, and achieve the objectives of the Energy Efficiency Plan.

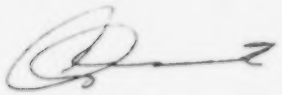
## Financing

The 2006 borrowing program amounts to $3.1 billion. The proceeds will be used to refinance debt maturing this year and to sustain growth in the investment program.

During the second quarter, the Corporation reopened, for the fourth time this year, the bond issue it launched in January 2005, maturing in February 2040. The $572-million proceeds were in addition to the $588 million from the previous issue, which closed in

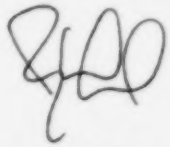
early April 2006. Borrowings since the beginning of the year stand at $2.3 billion; they have all been made on the Canadian market, at an average cost of 4.93%.

On June 30, Hydro-Québec received the nearly $1.8-billion proceeds from the sale of Transelec. This amount was added to the financing obtained since the beginning of the year.



Michael L. Turcotte

Chairman of the Board



Thierry Vandal

President and Chief Executive Officer

August 21, 2006

## CONSOLIDATED STATEMENTS OF OPERATIONS

In millions of Canadian dollars
(unaudited)

| | Notes | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|---|
| | | **2006** | 2005 | **2006** | 2005 |
| **Revenue** | | **2,604** | 2,455 | **5,808** | 5,575 |
| **Expenditure** | | | | | |
| Operations | | **576** | 592 | **1,143** | 1,129 |
| Electricity and fuel purchases | | **284** | 344 | **647** | 676 |
| Depreciation and amortization | | **496** | 449 | **985** | 932 |
| Taxes | | **89** | 114 | **242** | 263 |
| | | **1,445** | 1,499 | **3,017** | 3,000 |
| **Operating income** | | **1,159** | 956 | **2,791** | 2,575 |
| Financial expenses | 3 | **559** | 567 | **1,093** | 1,149 |
| Income from continuing operations | | **600** | 389 | **1,698** | 1,426 |
| Discontinued operations | 4 | **842** | 13 | **873** | 30 |
| **Net income** | | **1,442** | 402 | **2,571** | 1,456 |

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

In millions of Canadian dollars
(unaudited)

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Balance at beginning of period | **14,204** | 13,003 | **13,075** | 11,949 |
| Net income | **1,442** | 402 | **2,571** | 1,456 |
| Balance at end of period | **15,646** | 13,405 | **15,646** | 13,405 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## CONSOLIDATED BALANCE SHEETS

In millions of Canadian dollars

| | Notes | As at June 30 2006 (unaudited) | As at December 31 2005 (audited) |
|---|---|---|---|
| **ASSETS** | | | |
| **Property, plant and equipment** | | **51,067** | 50,588 |
| **Current assets** | | | |
| Cash and cash equivalents | | **2,162** | 16 |
| Investments | | **1,036** | 322 |
| Accounts receivable | | **1,866** | 1,764 |
| Swaps and sinking funds | | **860** | 685 |
| Materials, fuel and supplies | | **374** | 343 |
| Assets held for sale | 4 | **150** | 145 |
| | | **6,448** | 3,275 |
| **Other long-term assets** | | | |
| Investments | | **230** | 221 |
| Swaps and sinking funds | | **2,089** | 1,749 |
| Goodwill | | **10** | 10 |
| Intangible assets | | **604** | 639 |
| Other assets | | **1,856** | 1,784 |
| Assets held for sale | 4 | **168** | 2,166 |
| | | **4,957** | 6,569 |
| | | **62,472** | 60,432 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | | |
| **Long-term debt** | | **33,034** | 31,279 |
| **Current liabilities** | | | |
| Borrowings | | **57** | 20 |
| Accounts payable and accrued liabilities | | **1,819** | 1,929 |
| Dividends payable | | **-** | 1,126 |
| Accrued interest | | **888** | 927 |
| Current portion of long-term debt | | **2,806** | 3,148 |
| Liabilities related to assets held for sale | 4 | **88** | 172 |
| | | **5,658** | 7,322 |
| **Asset retirement obligations** | 5 | **419** | 282 |
| **Other long-term liabilities** | | **2,877** | 2,548 |
| **Long-term liabilities related to assets held for sale** | 4 | **132** | 1,213 |
| **Perpetual debt** | | **360** | 379 |
| **Non-controlling interest** | | **7** | 33 |
| **Shareholder's equity** | | | |
| Share capital | | **4,374** | 4,374 |
| Retained earnings | | **15,646** | 13,075 |
| Translation adjustments | | **(35)** | (73) |
| | | **19,985** | 17,376 |
| | | **62,472** | 60,432 |
| Commitments and contingencies | 8 | | |

*The accompanying notes are an integral part of the consolidated financial statements.*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

In millions of Canadian dollars
(unaudited)

| | Notes | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|---|
| | | **2006** | 2005 | **2006** | 2005 |
| **Operating activities** | | | | | |
| Income from continuing operations | | **600** | 389 | **1,698** | 1,426 |
| Non-cash items | | | | | |
| Depreciation and amortization | | | | | |
| Property, plant and equipment | | **433** | 411 | **867** | 839 |
| Intangible assets | | **28** | 27 | **57** | 54 |
| Regulatory assets | | **28** | (2) | **51** | 13 |
| Deferred charges | | **4** | 5 | **7** | 9 |
| Discounts and other deferred credits related to long-term debt | | **(401)** | (39) | **(451)** | (61) |
| Other | | **(10)** | 62 | **12** | 148 |
| Change in non-cash working capital items | | **850** | 624 | **(351)** | (299) |
| | | **1,532** | 1,477 | **1,890** | 2,129 |
| **Investing activities** | | | | | |
| Property, plant and equipment and intangible assets | | **(805)** | (886) | **(1,431)** | (1,373) |
| Long-term investments | | **2** | (2) | **2** | 1 |
| Disposal of investments, net of divested cash and cash equivalents | | **1,778** | - | **1,942** | - |
| Net change in short-term investments | | **(930)** | - | **(707)** | 60 |
| Other | | **(31)** | (23) | **(62)** | (57) |
| | | **14** | (911) | **(256)** | (1,369) |
| **Financing activities** | | | | | |
| Issuance of long-term debt | | **1,336** | 572 | **2,730** | 2,767 |
| Repayment of long-term debt at maturity and sinking fund redemption | | **2** | (215) | **(661)** | (789) |
| Prepayment of long-term debt | | **(221)** | (248) | **(221)** | (248) |
| Inflows resulting from credit risk management | | **380** | 95 | **465** | 290 |
| Outflows resulting from credit risk management | | **(680)** | (25) | **(730)** | (290) |
| Net change in short-term borrowings | | **(312)** | - | **37** | 4 |
| Dividends paid | | **-** | - | **(1,126)** | (1,350) |
| Other | | **(2)** | 3 | **(2)** | 3 |
| | | **503** | 182 | **492** | 387 |
| **Change in foreign exchange on cash and cash equivalents** | | **-** | 3 | **(1)** | 5 |
| Cash flows from continuing operations | | **2,049** | 751 | **2,125** | 1,152 |
| Cash flows from discontinued operations | 4 | **(57)** | 31 | **(45)** | 24 |
| **Net change in cash and cash equivalents** | | **1,992** | 782 | **2,080** | 1,176 |
| **Cash and cash equivalents at beginning of period** | | **180** | 491 | **92** | 97 |
| **Cash and cash equivalents at end of period** | | **2,172** | 1,273 | **2,172** | 1,273 |
| **Cash and cash equivalents** | | | | | |
| Continuing operations | | | | **2,162** | 1,273 |
| Discontinued operations | | | | **10** | - |
| | | | | **2,172** | 1,273 |
| Supplementary cash flow information | 6 | | | | |

*The accompanying notes are an integral part of the consolidated financial statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Six-month periods ended June 30, 2006 and 2005
*Amounts in tables are in millions of Canadian dollars.*

### Note 1 - Basis of Presentation

The quarterly consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the regulatory accounting procedures and practices that are accepted by the Régie de l'énergie (the Régie). These regulatory procedures and practices affect the timing of the recognition of certain costs in the consolidated operations, resulting in the recognition of regulatory assets. The quarterly consolidated financial statements and the present Notes should be read in conjunction with the Consolidated Financial Statements and accompanying Notes in Hydro-Québec's *Annual Report 2005*.

The accounting policies used to prepare the quarterly consolidated financial statements conform to those described in Hydro-Québec's *Annual Report 2005*.

Certain figures from corresponding periods of the previous year have been reclassified in order to conform to the presentation adopted for the current year periods.

The Corporation's quarterly financial results are not necessarily indicative of results for the year on account of seasonal temperature fluctuations. Because of higher electricity demand during winter months, revenue from electricity sales in Québec is higher during the first and fourth quarters.

### Note 2 - Regulation

DISTRIBUTION

In decision D-2006-46 of March 20, 2006, the Régie granted an across-the-board increase of 5.33% in the Corporation's electricity rates, effective April 1, 2006. This increase takes into account a 7.75% return on the rate base in 2006, assuming a capital structure with 35% shareholder's equity.

TRANSMISSION

In decision D-2006-66 of April 18, 2006, the Régie authorized the Transmission Provider to modify its power transmission rates effective January 1, 2005. The impact of this decision is essentially a $170-million increase in the annual cost of transmission service for the native load, which is not integrated into the Corporation's current electricity rates. In its upcoming 2007 rate application to the Régie, the Distributor will propose that its 2008 rate application include a mechanism to recover the $340-million increase for 2005 and 2006. No regulatory assets were recognized in the consolidated financial statements, since this mechanism has not yet been approved by the Régie.

## Note 3 - Financial Expenses

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| **Interest** | | | | |
| Interest on debt securities | **606** | 570 | **1,180** | 1,151 |
| Amortization of discounts and borrowing expenses | **1** | 9 | **3** | 18 |
| | **607** | 579 | **1,183** | 1,169 |
| **Exchange (gain) loss** | **(2)** | 13 | **(9)** | 35 |
| **Loan guarantee fees**[a] | **40** | 39 | **80** | 78 |
| | **38** | 52 | **71** | 113 |
| Less | | | | |
| Capitalized financial expenses | **76** | 61 | **144** | 123 |
| Net investment income | **10** | 3 | **17** | 10 |
| | **86** | 64 | **161** | 133 |
| | **559** | 567 | **1,093** | 1,149 |

*a) Guarantee fees paid to the shareholder*

## Note 4 - Discontinued Operations and Assets Held for Sale

### 2006

In 2005, Hydro-Québec adopted a plan to sell off some of its foreign interests. The related assets and liabilities were therefore classified as being held for sale. The results for these interests are classified under Corporate and Other Activities for the purpose of presenting segmented information. Further to the adoption of this plan, the following transactions took place in 2006:

On January 18, 2006, Hydro-Québec concluded the sale of its interest in Hidroeléctrica Río Lajas S.A., through its wholly owned subsidiary Hydro-Québec International (HQI), for a cash consideration of $5 million, giving rise to a loss on disposal of $0.3 million.

On February 27, 2006, Hydro-Québec concluded the sale of its interest in Cross-Sound Cable Company, LLC, for a cash consideration of $182 million, giving rise to a $29-million gain on disposal. The transaction includes the sale of units held and the repayment of the loan granted by Hydro-Québec to Cross-Sound Cable Company, LLC.

On March 29, 2006, Hydro-Québec concluded the sale of its interest in MurrayLink HQI Australia Pty Ltd, through HQI, for a cash consideration of $60 million. This transaction gave rise to a $2-million loss on disposal.

On June 30, 2006, Hydro-Québec sold its interest in HQI Transelec Chile S.A. (Transelec), held through HQI, for a cash consideration of $1.8 billion. This transaction gave rise to a gain on disposal of some $806 million, net of $222 million of related taxes. The sales contract further provides for price adjustments according to the market value of the regulated trunk transmission assets base, which is currently being evaluated by a consortium of independent experts, and to the retroactive effect of this valuation on Transelec's revenue for the period from March 13, 2004, through June 30, 2006. In Management's opinion, these adjustments should result in an additional gain which will be recognized when the final decision of the Chilean regulatory authority is made known.

In the second quarter of 2006, Hydro-Québec presented the assets and liabilities of its interest in Consorcio TransMantaro S.A., held through HQI, as assets and liabilities held for sale. On May 16, 2006, it signed an agreement to sell this interest for a consideration of US$67 million. This transaction should result in a gain on disposal that will be recognized at the closing, once the necessary approvals have been obtained from the Peruvian government authority.

### 2005

On July 15, 2005, Hydro-Québec concluded the sale of the principal assets held by its subsidiary HydroSolution, Limited Partnership, for a cash consideration of $92 million, resulting in a gain on disposal of $48 million. HydroSolution is part of the Distribution segment for the purpose of presenting segmented information.

## Note 4 - Discontinued Operations and Assets Held for Sale (continued)

The following table presents operating results and cash flows from the interests presented as discontinued operations:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| **Operations** | | | | |
| Revenue | **158** | 97 | **259** | 190 |
| Income before net gain on disposal | **34** | 13 | **40** | 30 |
| Net gain on disposal | **808** | - | **833** | - |
| Income from discontinued operations | **842** | 13 | **873** | 30 |
| **Cash flows** | | | | |
| Operating activities | **(65)** | 43 | **(27)** | 55 |
| Investing activities | **14** | (4) | **(3)** | (20) |
| Financing activities | **(1)** | (3) | **(11)** | (7) |
| Change in foreign exchange on cash and cash equivalents | **(5)** | (5) | **(4)** | (4) |
| Cash flows from discontinued operations | **(57)** | 31 | **(45)** | 24 |

The assets and liabilities sold, as at the disposal date, were as follows:

| | |
|---|---|
| Cash and cash equivalents | **123** |
| Other current assets | **33** |
| Long-term assets | **1,935** |
| Current liabilities | **163** |
| Long-term liabilities | **1,105** |
| | **823** |

## Note 5 - Asset Retirement Obligations

As at June 30, 2006, Hydro-Québec revised the principal underlying assumptions for estimating and calculating its obligations related to the dismantling of Gentilly-2 nuclear generating station and the removal of irradiated fuel. The total undiscounted amount of estimated cash flows required to settle the obligations, in current dollars, is $1,629 million, compared to $982 million as at December 31, 2005. The additional cash flows were discounted at a rate of 5.5%, resulting in an increase in asset retirement obligations and related fixed assets of $125 million as at June 30, 2006. This revision results in additional expenditure of approximately $16 million in 2006.

## Note 6 - Supplementary Cash Flow Information

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| **Change in non-cash working capital items** | | | | |
| Accounts receivable | **599** | 352 | **41** | (45) |
| Materials, fuel and supplies | **(4)** | (2) | **(30)** | (4) |
| Accounts payable and accrued liabilities | **(88)** | (34) | **(324)** | (184) |
| Accrued interest | **343** | 308 | **(38)** | (66) |
| | **850** | 624 | **(351)** | (299) |
| **Investing activities not affecting cash** | | | | |
| Increase in property, plant and equipment and intangible assets | **132** | 7 | **141** | 8 |
| **Cash and cash equivalents paid during the period** | | | | |
| Interest paid | **230** | 241 | **1,153** | 1,098 |

## Note 7 - Employee Future Benefits

| | Three months ended June 30 | | | |
|---|---|---|---|---|
| | Pension Plan | | Other plans | |
| | **2006** | 2005 | **2006** | 2005 |
| Accrued benefit cost | **68** | 54 | **25** | 20 |

| | Six months ended June 30 | | | |
|---|---|---|---|---|
| | Pension Plan | | Other plans | |
| | **2006** | 2005 | **2006** | 2005 |
| Accrued benefit cost | **142** | 95 | **49** | 40 |

## Note 8 - Commitments and Contingencies

### Guarantees

As at June 30, 2006, the potential maximum amount Hydro-Québec could have to pay under letters of credit or guarantees totaled $395 million. Of this amount, $312 million relates to the purchase of energy, for which a liability in the amount of $15 million has been recorded. Some guarantees expire between 2006 and 2019, while others do not have maturity dates.

As at June 30, 2006, Hydro-Québec provided guarantees to the purchasers of its interests concerning all its declarations and guarantees in the sales agreements. The maximum contingent risk under these guarantees represents an amount of approximately $273 million, excluding contingent tax liabilities and certain other customary declarations. The declarations and guarantees of the Corporation apply for a period ending no later than June 30, 2007, except with respect to the contingent tax liabilities and certain other customary declarations which remain in effect until the applicable limitation periods expire.

## Note 9 - Segmented Information

Since the first quarter of 2006, the Corporate and Other Activities segment has included the Technology Group, largely made up of telecommunications activities.

Three months ended
June 30, 2006

| | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Intersegment eliminations | Total |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| **External customers[a]** | 477 | 7 | 2,099 | - | 21 | - | **2,604** |
| **Intersegment** | 986 | 864 | 13 | 472 | 283 | (2,618) | - |
| **Income (loss) from continuing operations** | 534 | 333 | (261) | - | (9) | 3 | **600** |
| **Discontinued operations** | - | - | - | - | 842 | - | **842** |
| **Net income (loss)** | 534 | 333 | (261) | - | 833 | 3 | **1,442** |
| **Total assets as at June 30, 2006** | 28,009 | 15,689 | 10,681 | 230 | 8,088 | (225) | **62,472** |

*a) During the quarter, a $234-million foreign exchange gain was recognized on debts and swaps denominated in U.S. dollars. In keeping with the adopted hedge accounting treatment, this amount, which represents the realization of a portion of the deferred foreign exchange gain recorded on the balance sheet, has been incorporated into other operating revenue.*

Three months ended
June 30, 2005

| | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Intersegment eliminations | Total |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| **External customers** | 390 | 5 | 2,045 | 2 | 17 | (4) | 2,455 |
| **Intersegment** | 1,003 | 619 | 14 | 526 | 264 | (2,426) | - |
| **Income (loss) from continuing operations** | 392 | 116 | (94) | 3 | (27) | (1) | 389 |
| **Discontinued operations** | - | - | 4 | - | 9 | - | 13 |
| **Net income (loss)** | 392 | 116 | (90) | 3 | (18) | (1) | 402 |
| **Total assets as at June 30, 2005** | 27,002 | 15,362 | 10,299 | 226 | 6,942 | (216) | 59,615 |

## Note 9 - Segmented information (continued)

Six months ended
June 30, 2006

| | *Generation* | *Transmission* | *Distribution* | *Construction* | *Corporate and Other Activities* | *Intersegment eliminations* | *Total* |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| **External customers[a]** | 911 | 16 | 4,849 | - | 33 | (1) | **5,808** |
| **Intersegment** | 2,373 | 1,487 | 27 | 838 | 543 | (5,268) | **-** |
| **Income (loss) from continuing operations** | 1,341 | 427 | (48) | - | (24) | 2 | **1,698** |
| **Discontinued operations** | - | - | - | - | 873 | - | **873** |
| **Net income (loss)** | 1,341 | 427 | (48) | - | 849 | 2 | **2,571** |
| **Total assets as at June 30, 2006** | 28,009 | 15,689 | 10,681 | 230 | 8,088 | (225) | **62,472** |

*a) During the second quarter, a $234-million foreign exchange gain was recognized on debts and swaps denominated in U.S. dollars. In keeping with the adopted hedge accounting treatment, this amount, which represents the realization of a portion of the deferred foreign exchange gain recorded on the balance sheet, has been incorporated into other operating revenue.*

Six months ended
June 30, 2005

| | *Generation* | *Transmission* | *Distribution* | *Construction* | *Corporate and Other Activities* | *Intersegment eliminations* | *Total* |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| **External customers** | 791 | 10 | 4,776 | 2 | 18 | (22) | 5,575 |
| **Intersegment** | 2,352 | 1,236 | 27 | 811 | 512 | (4,938) | - |
| **Income (loss) from continuing operations** | 1,107 | 199 | 182 | 3 | (63) | (2) | 1,426 |
| **Discontinued operations** | - | - | 5 | - | 25 | - | 30 |
| **Net income (loss)** | 1,107 | 199 | 187 | 3 | (38) | (2) | 1,456 |
| **Total assets as at June 30, 2005** | 27,002 | 15,362 | 10,299 | 226 | 6,942 | (216) | 59,615 |

## Note 10 – Subsequent Event

On August 1, 2006, Hydro-Québec concluded the sale of its interest in HQI Latin America Ltd., through HQI, for a cash consideration of US$100 million. This transaction gave rise to a gain on disposal of some C$40 million, which will be recorded in the next quarter.

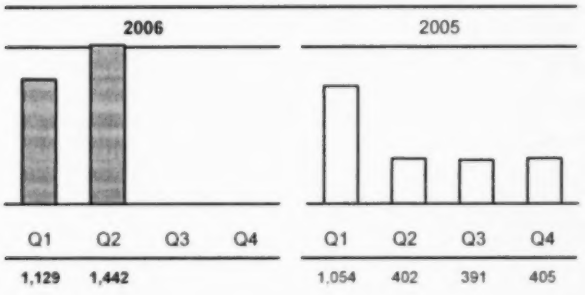
## CONSOLIDATED FINANCIAL HIGHLIGHTS

In millions of Canadian dollars
(unaudited)

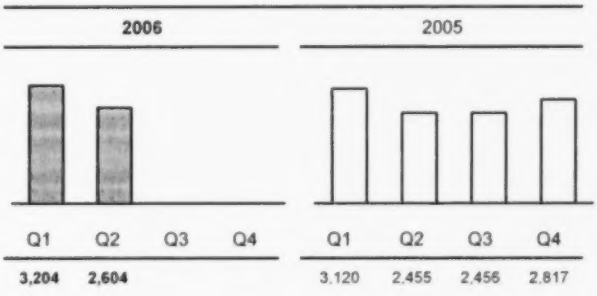
### Summary of Operations

| | Three months ended June 30 | | | | Six months ended June 30 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2006** | 2005 | Change (%) | | **2006** | 2005 | Change (%) | |
| Revenue | **2,604** | 2,455 | 6.1 | ↑ | **5,808** | 5,575 | 4.2 | ↑ |
| Expenditure | **1,445** | 1,499 | 3.6 | ↓ | **3,017** | 3,000 | 0.6 | ↑ |
| Financial expenses | **559** | 567 | 1.4 | ↓ | **1,093** | 1,149 | 4.9 | ↓ |
| Discontinued operations | **842** | 13 | 6,376.9 | ↑ | **873** | 30 | 2,810.0 | ↑ |
| Net income | **1,442** | 402 | 258.7 | ↑ | **2,571** | 1,456 | 76.6 | ↑ |

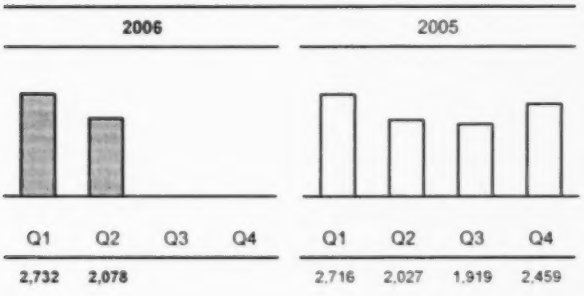
**Net Income**



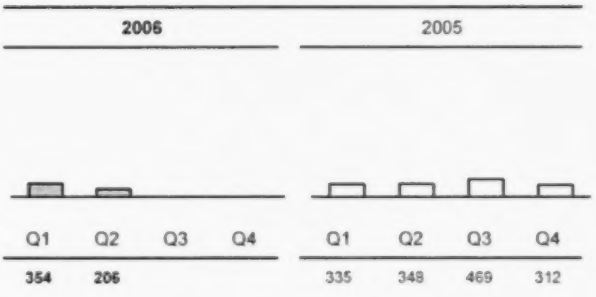

**Revenue**




**Revenue from Electricity Sales in Québec**




**Revenue from Electricity Sales Outside Québec**



# Quarter Highlights

## *Sale of two international holdings*

In June, Hydro-Québec sold its 92% interest in HQI Transelec Chile S.A., which was held through its subsidiary Hydro-Québec International, for nearly $1.8 billion. The buyer was a consortium led by the Canadian firm Brookfield Asset Management and made up of Canadian institutional investors. The transaction, which closed on June 30, yielded a profit of about $806 million. Transelec is a transmission provider that serves 99% of the Chilean population.

In May, Hydro-Québec reached an agreement to sell its 57% stake in Consorcio TransMantaro S.A. for US$67 million to a consortium formed by the Colombian companies Interconexión Eléctrica S.A.E.S.P. (60%) and Empresa de Energía de Bogotá S.A.E.S.P. (40%). Consorcio TransMantaro operates an interconnection line in Peru that runs along the Andean Cordillera. The transaction is subject to the approval of the Peruvian authorities, including the country's antitrust commission (Indecopi).

These two transactions fit in with Hydro-Québec's strategy to sell off its foreign interests and focus its resources and efforts on its core operations.

## *Amendment of conditions of transmission service*

In April, the Régie de l'énergie rendered its decision on Phase II of Hydro-Québec TransÉnergie's application to amend the conditions of transmission service. The decision recognizes $72.90 per kilowatt as a fair rate for annual point-to-point transmission service, and $8.33 per megawatthour for hourly point-to-point transmission service. It also recognizes the cost submitted by the Transmission Provider for native load transmission service, which reflects the cost of the transmission infrastructure required to meet demand growth in Québec. This decision, effective January 1, 2005, represents a $170-million increase in the Distributor's annual cost of transmission service for the native load. It also amends some of the conditions of transmission service. Customers will not experience any rate impact in 2006 from the decision.

## *Labor relations*

In June, the company and its unions signed several agreements that, among other things, concluded the various steps involved in achieving pay equity, introducing new appraisal plans for all employees concerned, and setting the working conditions that will remain in effect until the collective agreements expire on December 31, 2008, or December 31, 2009, as the case may be.

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